

Message Text

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ACTION EA-12

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C O R R E C T E D C O P Y (TEXT PARA ONE)

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E.O. 11652: N/A
TAGS: ETRD, EGEN, JA
SUBJECT: CORRECTING JAPAN'S CURRENT ACCOUNT SURPLUS.
- WHAT, IF ANYTHING, WILL WORK?

1. SUMMARY: SEVERAL INFLUENCES ARE OPERATING TO REDUCE
JAPAN'S CURRENT ACCOUNT SURPLUS, MOST NOTABLY YEN APPRE-
CIATION, STRUCTURAL CHANGE IN JAPAN, AND INCREASING U.S.
EXPORT AWARENESS. ADVANCE PURCHASES AND JAPANESE EXPORT
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RESTRAINTS MAY GIVE SOME TEMPORARY RELIEF.

WE DO NOT KNOW HOW QUICKLY THE CORRECTION WILL COME, BUT
JAPAN ACCEPTS THE NECESSITY OF REDUCING ITS C/A SURPLUS
SIGNIFICANTLY, IF NOT THAT OF ACHIEVING A DEFICIT. WE
NEED TO KEEP ALL THE FACTORS IN MIND, TO REMIND THE
JAPANESE FOUR INTEREST IN SEEING PROGRESS ON ALL OF THEM

AND TO KEEP CHANNELS OF COMMUNICATION OPEN SO WE CAN SHARE
MUTUAL PERCEPTIONS OF WHERE WE STAND. END SUMMARY.

2. EMBASSY FELT IT WOULD BE USEFUL TO WASHINGTON TO SEE
OUR EVALUATION OF WHERE WE STAND IN THE GOAL OF REDUCING
JAPAN'S CURRENT ACCOUNT SURPLUS TOWARD THE WORLD. WE
KEEP LOOKING FOR THE EVENT WHICH WILL MARK THE TURNING
OF THE CORNER OR REVERSING THE TREND OF JAPAN'S RISING
CURRENT ACCOUNT SURPLUSES. BUT RATHER THAN A SINGLE DRAMA-
TIC EVENT, IT IS MORE LIKELY THAT CHANGE WILL BE GRADUAL
AND THAT THE CAUSES WILL BE NUMEROUS. THERE ARE NINE
FACTORS WHICH WILL MAKE A DIFFERENCE; TWO WHICH MAY HELP
TEMPORARILY, AND ONE POTENTIALLY NEGATIVE. THOSE WHICH
WILL HELP ARE YEN APPRECIATION, CHANGES IN OVERALL COMPE-
TITIVENESS, STRUCTURAL CHANGE IN JAPAN, ECONOMIC RECOVERY
IN JAPAN, INCREASING U.S. EXPORT PROMOTION AND EXPORT
CONSCIOUSNESS, BETTER ACCESS TO JAPANESE MARKETS, IMPORT
SUBSTITUTION EFFECTS OF JAPANESE INVESTMENT IN THE U.S.,
UNTIED JAPANESE AID, AND TOURISM. SOME TEMPORARY RELIEF
MAY COME FROM JAPANESE EXPORT RESTRAINTS AND ADVANCE
PURCHASES. INFLATION IN THE U.S. IS PROBABLY NOT A SERIOUS
INHIBITING FACTOR, BUT COULD BECOME SO.

HOW QUICKLY THE CORRECTION OF JAPAN'S CURRENT ACCOUNT WILL
COME WE CANNOT SAY, NOR DO WE KNOW HOW FAR IT WILL GO.
OUR OBJECTIVE IS A REDUCTION ALL THE WAY TO ZERO, AND
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BEYOND. THAT IS NOT THE OBJECTIVE OF THE JAPANESE GOVERN-
MENT AND WE WILL HAVE SOME PERSUADING TO DO TO GET THE
JAPANESE TO ACCEPT THAT OBJECTIVE. HOWEVER THERE IS A
CLEAR RECOGNITION OF THE NEED TO MAKE SIGNIFICANT REDUCTIONS
IN THE CURRENT ACCOUNT SURPLUS; WE CAN FRUITFULLY HELP TO
PUSH THAT PROCESS ALONG.

3. THERE FOLLOW BRIEF COMMENTS ON THE VARIOUS FACTORS AT
PLAY:

YEN APPRECIATION:

APPRECIATION OF THE YEN (BY 16 PERCENT SINCE JANUARY 1 BY
23.6 PERCENT SINCE JULY 1, 1977) WILL HAVE AN IMPORTANT
EFFECT. IF THE LAWS OF ECONOMICS STILL MEAN ANYTHING, IT
WILL INFLUENCE EVERY TRANSACTION AND EVERY TRADE DECISION.
APPRECIATION SHIFTS INCOME FROM EXPORTERS TO IMPORTERS.
ITS IMPACT MAY BE SLOW, DEPENDING ON HOW TRADERS RESPOND,
BUT IT IS THERE EVEN WHERE THE PRICE ELASTICITIES ARE LOW.
THERE IS NO ONE RATE WHICH WILL INSTANTLY AND QUICKLY
PRODUCE EQUILIBRIUM, BUT IN TIME MARKETS AND TRADE WILL
RESPOND AND STABILIZE.

4. OVERALL COMPETITIVENESS:

JAPAN'S TREMENDOUS EXPORT STRENGTH IS CONCENTRATED PRIMARILY IN SHIPS, STEEL, AUTOS AND CONSUMER ELECTRONICS. JAPAN'S PRODUCTION CAPACITY IN THESE INDUSTRIES IS IN GENERAL THE MOST MODERN IN THE WORLD. HOWEVER, JAPAN'S WORK FORCE AND CAPITAL ARE AGING AND COSTS ARE RISING STEADILY. THE COST OF NEW CAPITAL EQUIPMENT AND THE LAND TO PUT IT ON ARE ALSO RISING. IMPORTED ENERGY AND RAW MATERIALS ARE NOW RELATIVELY CHEAP IN YEN TERMS, BUT ARE LIKELY TO BECOME MORE EXPENSIVE. U.S. COMPETITIVENESS IN THESE INDUSTRIES MAY INCREASE; FROM THIRD COUNTRIES COMPETITION WILL DEFINITELY INCREASE. TO SOME EXTENT LIMITED OFFICIAL USE

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JAPAN WILL SHIFT TO NEW AREAS, ESPECIALLY INTO INFORMATION-ORIENTED INDUSTRY, BUT EVEN IN NEW FIELD JAPAN IS LIKELY TO BE RELATIVELY LESS COMPETITIVE.

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5. STRUCTURAL CHANGE:

THE PERMANENT SOLUTION TO THE PROBLEM OF JAPAN'S RECURRING CURRENT ACCOUNT SURPLUSES IS MAJOR STRUCTURAL CHANGE IN THE JAPANESE ECONOMY. IT IS FAIR TO SAY THAT THE JAPANESE ECONOMY IS BASICALLY STRUCTURED TO FUNCTION SMOOTHLY AT ANNUAL GROWTH RATES OF 10 PERCENT OR MORE WHILE MAINTAINING APPROXIMATE CURRENT ACCOUNT EQUILIBRIUM. THE ADJUSTMENT TO LOWER RATES OF GROWTH SINCE 1972 HAS CREATED MANY STRAINS IN THE JAPANESE ECONOMY. ALONG WITH UNACCUSTOMED UNEMPLOYMENT AND BANKRUPTCIES HAVE COME STRONG INCENTIVES

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TO EXPORT IN A SEARCH FOR NEW MARKETS. THUS JAPAN IS RUNNING UNUSUALLY LARGE EXPORT SURPLUSES WHILE DEMAND FOR IMPORTS REMAINS STEADY. IN TIME, BUSINESS DECISION MAKERS WILL CONCENTRATE THEIR EFFORTS ON NEW ACTIVITIES MORE IN ACCORD WITH CURRENT EXCHANGE RATES AND PROFIT OPPORTUNITIES AND LESS ORIENTED TO FOREIGN MARKETS. JAPANESE GOVERNMENT POLICY CAN HASTEN THAT PROCESS. NEW LEGISLATION ENACTED BY THE DIET AUTHORIZES MITI TO ENCOURAGE ADJUSTMENT IN DEPRESSED INDUSTRIES. SO FAR MITI IS USING THE AUTHORITY PRIMARILY TO CLOSE OUT INEFFICIENT PRODUCTION CAPACITY IN SMALL STEEL, ALUMINUM, AND SYNTHETIC FIBERS. MITI COULD PUSH THIS PROCESS FAR ENOUGH TO CREATE NEW OPPORTUNITIES FOR FOREIGN SUPPLIERS, AND IT WOULD BE HIGHLY DESIRABLE FOR THE JAPANESE TO UTILIZE THIS AUTHORITY AS A POSITIVE ADJUSTMENT MECHANISM WHICH WOULD EFFECTIVELY PROMOTE A GLOBAL CURRENT ACCOUNT BALANCE. IN THE PAST WE HAVE OBJECTED TO JAPANESE PLANNING PROPOSALS WHICH PREDICATE THAT IN FUTURE YEARS SIGNIFICANT CURRENT ACCOUNT BALANCES WILL BE MAINTAINED. WE WILL CONTINUE TO DO SO. MITI'S JUST ISSUED TRADE "WHITE PAPER" INDICATES THAT A HIGHER PROPORTION OF IMPORTS OF MANUFACTURES, AND INDUSTRIAL RESTRUCTURING TO ADJUST TO A REASONABLE INTERNATIONAL ECONOMIC SYSTEM, ARE NECESSARY.

6. ECONOMIC RECOVERY:

WE ARE RELYING ON INCREASED GROWTH OF INTERNAL DEMAND TO INCREASE JAPANESE IMPORTS. TO DATE A SIGNIFICANT PART OF TOTAL GROWTH HAS BEEN EXPORTS. THAT IS NOT DESIRABLE, AND INDICATIONS ARE THAT IT WILL NOT CONTINUE. INTERNAL DEMAND FOR CONSUMPTION, INVESTMENT AND INVENTORY BUILDING IS

DESIRABLE AND SEEMS TO BE EXPANDING. THIS WILL HELP REDUCE EXPORTS AND INCREASE IMPORTS.

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7. U.S. EXPORT CONSCIOUSNESS AND EXPORT PROMOTION:

THROUGHOUT THE ENTIRE POST WAR PERIOD, DESPITE OCCASIONAL BALANCE OF PAYMENTS PROBLEMS, U.S. BUSINESS HAS DONE EXTREMELY WELL BY FOCUSING PRIMARILY ON DOMESTIC MARKETS AND GIVING LITTLE EMPHASIS TO EXPORTS. AMERICANS HAVE LITTLE EXPORT CONSCIOUSNESS BECAUSE WE HAVE NOT NEEDED IT. HOWEVER, CONDITIONS ARE CHANGING. U.S. BUSINESS MUST DEVELOP A BETTER ORIENTATION TO THE IMPORTANCE AND VALUE OF EXPORTS. THE PRESIDENT'S EXPORT TASK FORCE IS A USEFUL STEP. GENERAL EXPORT PROMOTION AND THE U.S. EXPORT DEVELOPMENT MISSIONS TO JAPAN ARE OTHERS. WE NEED A COMPREHENSIVE PROGRAM WHICH TILTS THE ADVANTAGES AND THE STRUCTURE OF GOVERNMENT REGULATIONS MORE STRONGLY IN FAVOR OF EXPORTS.

8. ACCESS TO JAPANESE MARKETS:

WE ARE UNDERSTRONG PRESSURE TO ACHIEVE SOME QUICK SUCCESSES IN IMPROVING ACCESS TO JAPAN AS A MARKET FOR U.S. PRODUCTS. THE MULTILATERAL TRADE NEGOTIATIONS IS THE PRINCIPAL FORUM AT WHICH IMPROVED ACCESS TO JAPAN WILL BE NEGOTIATED, TO THE EXTENT THAT IT CAN BE NEGOTIATED. THE TRADE FACILITATION COMMITTEE (TFC) IS A MORE IMMEDIATE AND DIRECT MECHANISM FOR US TO RAISE BOTH GENERAL AND SPECIFIC TRADE PROBLEMS. IN THE TFC WE HAVE BEEN LOOKING FOR SOME QUICK SUCCESS STORIES, HAVE HAD A FEW, AND HAVE ALSO HAD SOME FAILURES. WE WILL HAVE TO CONTINUE WORKING THROUGH THAT MECHANISM, PUBLICIZING SUCCESSES WHEN WE ACHIEVE THEM, AND KEEPING TRACK OF THE FAILURES WITH A VIEW TO RAISING THEM AT A HIGHER LEVEL WHENEVER WE CAN DOCUMENT A CASE THAT ACCESSIBILITY TO JAPAN AS A MARKET IS NOT AS GOOD AS IT SHOULD BE. WHEN WE FAIL ON THE FIRST ATTEMPT WE MAY NEVERTHELESS ACHIEVE PARTIAL SUCCESS LATER ON IF WE CONTINUE THE EFFORT. WE ARE SEEKING ENHANCED IMPORT CONSCIOUSNESS ON THE PART OF JAPANESE. THESE ARE NEW AND STRANGE THOUGHT PATTERNS FOR JAPANESE WHO HAVE

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BEEN CONDITIONED TO THINK OF EXPORTS FIRST, AND IT WILL TAKE TIME TO LEARN THEM.

9. INVESTMENT:

JAPANESE BUSINESS FIRMS HAVE ALREADY EXHIBITED CONSIDER-

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ABLE INTEREST IN INVESTMENT IN PRODUCTION FACILITIES IN
THE UNITED STATES. THEY FIND ECONOMIC CONDITIONS FAVORABLE
AND THEIR FACTORIES ARE WELCOMED. HONDA IS STARTING
MOTORCYCLE PRODUCTION IN OHIO AND WILL PROBABLY MOVE TO
AUTOS. SONY, MATSUSHITA, SANYO, AND MITSUBISHI HAVE
ALREADY INVESTED IN COLOR TV PRODUCTION FACILITIES IN THE
U.S. HITACHI AND TOSHIBA PLAN TO JOIN THEM SOON. THESE
INVESTMENTS WERE ONLY PARTLY PROMPTED BY THE OMA ON COLOR
TVS FROM JAPAN. JAPANESE FIRMS ARE ALSO INVESTING IN MANY
OTHER ENTERPRISES IN THE UNITED STATES, AND THESE FACILI-
TIES TO A CONSIDERABLE EXTENT WILL SUBSTITUTE FOR DIRECT
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JAPANESE EXPORTS.

10. UNTIED JAPANESE AID:

INCREASED JAPANESE AID WITH UNTYING, TO THE EXTENT THAT IT TRANSFERS PROCUREMENT TO THIRD COUNTRIES, WILL ALSO REDUCE THE CURRENT ACCOUNT SURPLUS.

11. TOURISM:

THE JAPANESE ARE DEVOTED TRAVELLERS. THIS IS ALREADY A \$2.15 BILLION ITEM ON JAPAN'S CURRENT ACCOUNT AND IT IS BOUND TO GROW. IF THE NUMBER OF AIR FLIGHTS TO AND FROM JAPAN COULD BE INCREASED AND LOWER FARES ALLOWED, WE COULD ANTICIPATE A RAPID INCREASE IN THE NUMBER OF JAPANESE GOING ABROAD. THIS WE SHOULD ENCOURAGE.

12. MAJOR ADVANCE PURCHASES:

THE JAPANESE ARE PUSHING AHEAD THEIR PLANS TO PURCHASE URANIUM AND URANIUM ENRICHMENT SERVICES. THESE COULD GENERATE IMMEDIATE CASH FLOWS OF AROUND \$1 BILLION. CONCEIVABLY MAJOR PURCHASES COULD BE MADE IN OTHER AREAS SUCH AS MEDICAL EQUIPMENT, HOUSING MATERIALS, AND RAW MATERIALS, INCLUDING GRAINS FOR STOCKPILES. SUCH PURCHASES ARE BASICALLY PALLIATIVES TO THE EXTENT THEY BRING FORWARD TO AN EARLIER DATE PURCHASES WHICH WOULD HAVE BEEN MADE ANYWAY. THUS THEY ARE ONLY WINDOW DRESSING. HOWEVER, THEY WILL HAVE AN EFFECT ON THE CURRENT ACCOUNT FIGURES, AND THEREFORE HAVE SOME COSMETIC USEFULNESS.

13. EXPORT RESTRAINTS:

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EXPORT RESTRAINTS ARE OF TWO TYPES. THERE ARE RESTRAINTS OF VARIOUS KINDS IMPOSED AT OUR INITIATIVE, SUCH AS ON STEEL, COLOR TV, TEXTILES AND OTHER PRODUCTS. THESE DO INHIBIT IMPORTS FROM JAPAN TO SOME EXTENT. NEVERTHELESS, THEY ARE AND OUGHT TO BE TEMPORARY MEASURES DESIGNED TO MEET PARTICULAR PROBLEMS OF SELECTED INDUSTRIES.

JAPANESE EXPORT RESTRAINTS IMPOSED THROUGH ADMINISTRATIVE GUIDANCE, OR OTHER JAPANESE GOVERNMENT POLICY MEASURES, ARE IN EFFECT ON MAJOR PRODUCTS SUCH AS AUTOS AND STEEL. THE EFFECT IS QUESTIONABLE. THEY ARE APPLIED ON A QUANTA-

TIVE BASIS AND IT IS NOT CERTAIN WHETHER THEY WILL ACTUALLY REDUCE SHIPMENTS. IF THEY DO HAVE A NET EFFECT IT WILL BE TEMPORARY. THE MORE FUNDAMENTAL RISK IS THAT THEY COULD RESTRICT DESIRABLE TRADE, CURTAIL COMPETITION, AND ENCOURAGE PROTECTIONIST ATTITUDES. THEREFORE WE CANNOT WELCOME EXPORT RESTRAINTS.

14. INFLATION:

RECENTLY INFLATION IN THE UNITED STATES HAS BEEN CITED AS A NEGATIVE INFLUENCE ON THE CURRENT ACCOUNT SITUATION. JAPANESE OFFICIALS, INCLUDING THE PRIME MINISTER, HAVE ALREADY POINTED TO U.S. INFLATION AS A POSSIBLE EXCUSE FOR JAPAN'S EVENTUAL FAILURE TO MEET CURRENT ACCOUNT TARGETS. THE FACTS AND PROSPECTS FOR INFLATION DO NOT REALLY SUPPORT SUCH A CONCLUSION. INFLATION IN THE UNITED STATES AT 6 OR 7 PERCENT IS NOT THAT MUCH HIGHER THAN INFLATION IN JAPAN AT ABOUT 5 PERCENT. THERE IS, HOWEVER, NO QUESTION THAT EFFECTIVE PROGRAMS AND POLICIES IN THE UNITED STATES TO REDUCE INFLATION, PROMOTE INVESTMENT, AND MAKE THE U.S. MORE COMPETITIVE WITH FOREIGN SUPPLIERS ARE IMPORTANT. THE PRESIDENT'S EXPORT PROMOTION TASK FORCE IS A USEFUL STEP.

15. CONCLUSION:

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WE BELIEVE THAT U.S. INTERESTS ARE BEST SERVED BY KEEPING ALL THE ABOVE FACTORS IN MIND AND WATCHING THEIR INTERPLAY IN THE WEEKS TO COME. DIFFERENT U.S. AGENCIES WILL STRESS DIFFERENT FACTORS BECAUSE OF THEIR OWN BUREAUCRATIC RESPONSIBILITIES; THEIR MESSAGE WILL BE RECEIVED BY VARIOUS PARTS OF THE JAPANESE DECISION MAKING STRUCTURE. WE

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SHOULD TAKE APPROPRIATE OPPORTUNITIES TO REMIND THE VARIOUS
JAPANESE WE COME INTO CONTACT WITH OF OUR CONTINUING
INTEREST; WE SHOULD GREET PROGRESS AND REGISTER UNHAPPI-
NEXX AT RETROGRESSION. ABOVE ALL WE SHOULD MAINTAIN A
STEADY DIALOGUE SO THAT THOSE IN JAPAN WHO WISH TO ARGUE
THAT JAPAN IS "UNDER PRESSURE FROM THE U.S. TO MAKE
CHANGES" WILL HAVE ADEQUATE REASON TO DO SO. THE PRE-
SUMMIT AND SUMMIT SESSIONS AND THE PROSPECTIVE SUB-CABINET
DISCUSSIONS WILL PROVIDE FORMAL SETTINGS FOR SUCH DIALOGUE.
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